

MEMO# 17148

February 27, 2004

HOUSE COMMITTEE APPROVES SECURITIES FRAUD LEGISLATION WITH SIGNIFICANT MUTUAL FUND AMENDMENTS

[17148] February 27, 2004 TO: BOARD OF GOVERNORS No. 15-04 FEDERAL LEGISLATION MEMBERS No. 6-04 PUBLIC COMMUNICATIONS COMMITTEE No. 11-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 20-04 RE: HOUSE COMMITTEE APPROVES SECURITIES FRAUD LEGISLATION WITH SIGNIFICANT MUTUAL FUND AMENDMENTS On February 25, the House Financial Services Committee approved an amended version of H.R. 2179, the Securities Fraud Deterrence and Investor Restitution Act of 2003. The legislation includes provisions that will increase the Securities and Exchange Commission's ability to investigate and deter fraud, levy and collect fines and disgorgement funds, and provide for an increase in the monies available for return to defrauded investors. During the Committee's markup, three amendments affecting mutual funds were approved by voice vote. An amendment offered by Representative Brad Miller (D-NC) would require all mutual fund boards to appoint either a lead independent director or an independent chair. The Institute believes that giving the mutual fund board the option of having an independent chair or a lead independent director provides the benefits of a strong source of independent leadership on the board, while providing board members the flexibility to determine which arrangement works best for their fund. An amendment that would have required all fund boards to have an independent chair was not offered. The Committee also approved an amendment offered by Representative Michael Castle (R-DE) that would prohibit the collection of 12b-1 fees by mutual funds that are closed to new investors. The Institute believes that the payment of 12b-1 fees in this circumstance is entirely appropriate because these fees are used to recoup monies the fund underwriter paid upfront to third parties, such as broker-dealers and other sales professionals, for providing advice and administrative services to fund shareholders. Finally, the Committee approved an amendment offered by Representative Paul Gillmor (R-OH) that would amend Section 15(c) of the Investment Company Act of 1940 by placing the responsibility on investment advisers and underwriters to inform the fund's board of directors of any business practices of those investment advisers and underwriters that are not in the best interests of the fund's shareholders. The Institute believes this amendment is unnecessary because the SEC's new fund compliance rule addresses this issue. In addition, the provision 2 would subject fund advisers to an open-ended obligation that will expose them to the risk of being second-guessed. A date for House floor consideration of this legislation has not been scheduled. The Senate Banking Committee is continuing its series of hearings on mutual funds. We will keep you informed as these matters continue to develop. Matthew P. Fink President

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